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Brazil: President Collor's Prospects on the Eve of the Rio Summit

National Intelligence Estimate

This National Intelligence Estimate represents the views of the Director of Central Intelligence with the advice and assistance of the US Intelligence Community

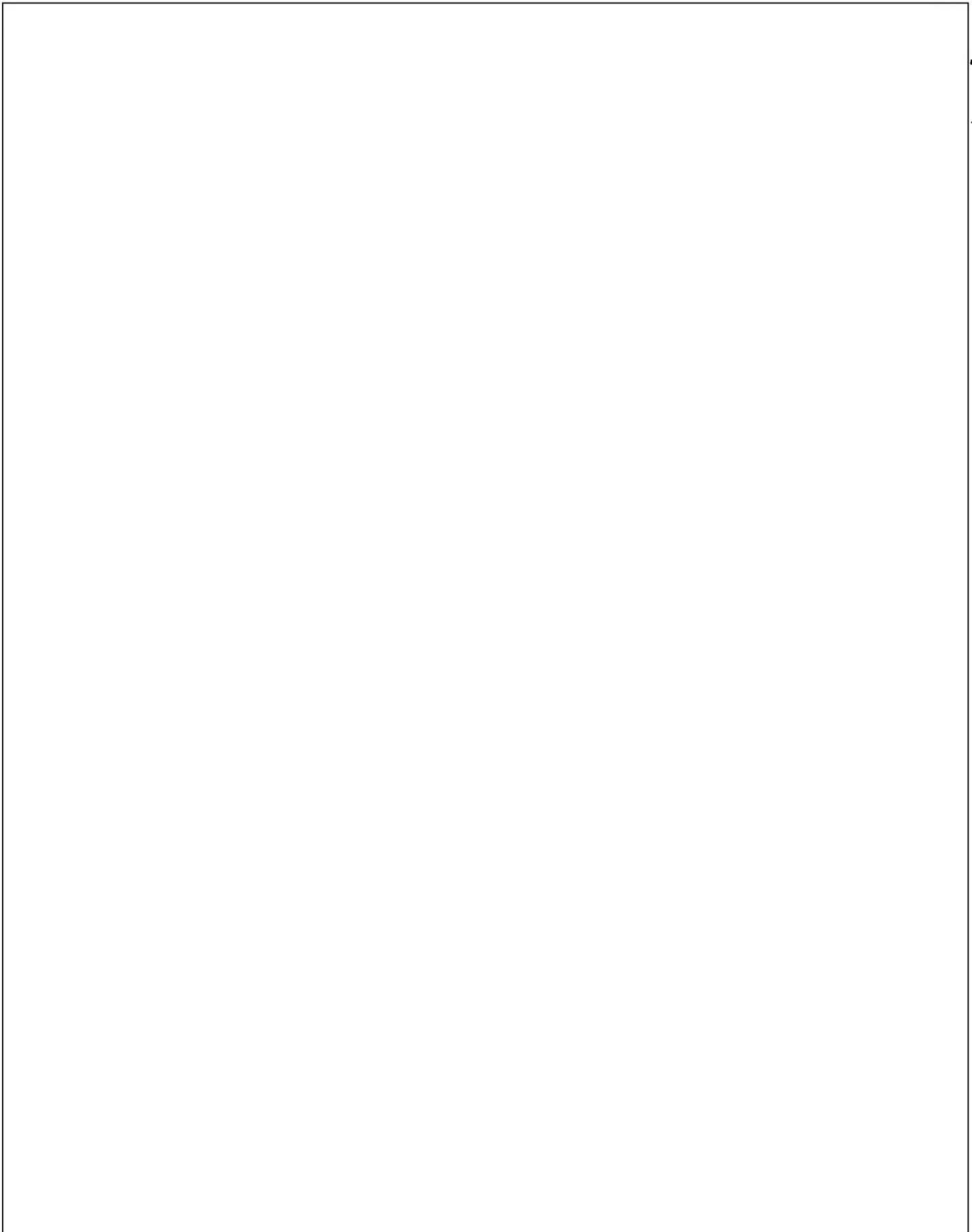
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Information available as of 4 June 1992 was used in the preparation of this National Intelligence Estimate.

The following intelligence organizations participated in the preparation of this Estimate:

The Central Intelligence Agency
The Defense Intelligence Agency
The National Security Agency
The Assistant Secretary for Intelligence and Research,
Department of State

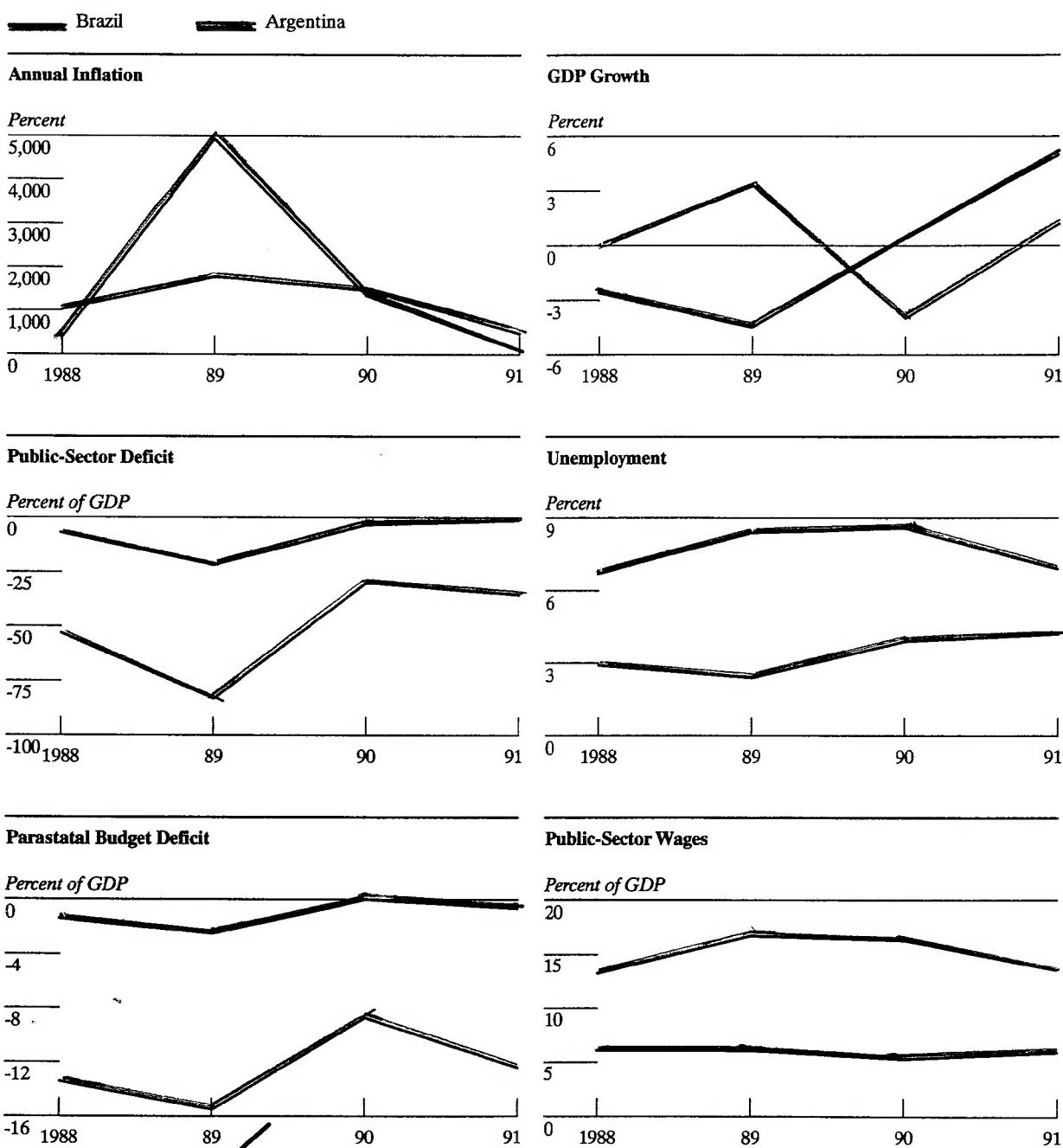
also participating:

The Deputy Chief of Staff for Intelligence,
Department of the Army
The Director of Naval Intelligence,
Department of the Navy
The Assistant Chief of Staff, Intelligence,
Department of the Air Force
The Director of Intelligence,
Headquarters, Marine Corps

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Figure 1
Economic Comparison of Brazil and Argentina, 1988-91



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Key Judgments

Brazil: President Collor's Prospects on the Eve of the Rio Summit

On the eve of the Rio de Janeiro global environmental summit, President Fernando Collor de Mello is confronting the most serious challenges yet to his presidency. Most significantly, he must win sufficient support in the fractious Congress to pass constitutional amendments and a package of economic reform legislation to cut inflation, generate strong economic growth, and gain political momentum.

The odds are somewhat better than even that he will win passage this year of most of the key provisions he wants. These will help to cut the budget deficit and improve business confidence. Collor is also likely to continue making significant gains in privatizing public companies.

But the economic results will be mixed over the next year or so, largely because Congress will not approve everything Collor needs. Monthly inflation will subside but probably not below 10 percent. Austerity, combined with continued political uncertainties, will keep economic growth at about 1 to 2 percent, well below the dramatic gains of Mexico, Chile, Argentina, Venezuela, and a number of other Latin American countries.

What if He Fails To Pass His Legislative Program?

There is about a 40- to 45-percent possibility the Congress will not approve the most critical portions of Collor's legislative package this year:

- As a result, his stabilization program would be derailed and the economy pushed into deep recession.
- Collor would become politically impotent, and constructive compromise with Congress would be highly unlikely.
- Strikes, protests, and food rioting would be likely, but the military probably would intervene only in the event of serious instability in one or more major cities and if elites openly called for them to act

Relations With the United States

Collor believes he has met most US concerns on issues that were nettlesome at the outset of his term. In conversations with President Bush and senior US officials, he and his associates will cite actions they have taken in areas such as nuclear safeguards, strategic trade controls, moves toward adherence to Missile Technology Control Regime guidelines, trade liberalization, and cooperation with the United States on GATT.

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Collor is not expecting to have in-depth discussions with President Bush on unresolved bilateral issues. Nonetheless, he believes that there has been a lack of reciprocity by the United States and other developed countries. While Collor may not react forcefully to this perceived inadequate response, he might smart from further admonitions that Brasilia needs to do more.

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Discussion¹

Fernando Collor is confronting what could be the most fundamental challenges to the success of his presidency. He must:

- Win sufficient support in the fractious Congress to ensure passage of constitutional amendments and complex legislation to cut the large fiscal deficit and undertake structural and other economic reforms.
- Drive high rates of inflation down over the next several months to restore confidence and attract investment.
- Prepare for municipal elections this October as well as a plebiscite next April over whether Brazil will retain its presidential system or adopt a parliamentary one.
- Deal with allegations of malfeasance against some senior government officials and of personal corruption—including drug use. []

Collor came to office in March 1990 committed to stabilizing and restructuring the economy by undertaking comprehensive free market reforms. He scored some initial successes by eliminating most trade barriers; making cuts in the bloated public-sector bureaucracy; launching an ambitious privatization program to divest the state of steel, petrochemicals, fertilizer, and transportation holdings; and nullifying more than 100,000 regulations that hobbled investors. []

The central goal of defeating inflation has failed, however, despite the implementation of two shock programs that temporarily froze wages, prices, and financial assets. Monthly inflation has been running at more than 20 percent since last October—the highest rate in Latin America. In part as a result of severe austerity measures, Brazil had a lower GDP growth rate last year—only about 1.2 percent—than all but a few of the Latin American countries. []

Why Is Brazil Lagging?

Collor's Leadership Style. Collor's youth and vigor, assured manner, vows to eradicate corruption and to remake Brazil, and his rejection of traditional politics

A New Economic Game Plan

Collor has discarded economic "shock therapy" because it has done little to get to the root causes of Brazil's economic woes and has generated discontent. He is now opting for broad structural reforms aimed at strengthening federal fiscal and monetary authority and at improving the confidence of both domestic and foreign investors. Some successes have been achieved in enhancing tax revenues, introducing pay-as-you-go corporate taxes, and curbing state borrowing. Important reforms await congressional approval or will soon be presented. Key proposals call for:

- *Increasing Brasilia's share of tax revenues, in part at the expense of state and municipal governments.*
- *Streamlining the tax system.*
- *Giving the federal government tools to reduce widespread tax evasion.*
- *Permitting the dismissal of some tenured public civil servants.*
- *Eliminating the government monopoly in the telecommunications sector.*
- *Opening the petroleum sector to foreign participation in refining, exporting, and importing, but not exploration and drilling.*
- *Allowing majority foreign ownership in the mining sector.* []

helped him to win office and to launch bold reforms. But, these traits also have been political liabilities that he has only recently begun to overcome. For example, even as his initial economic program faltered and inflation crept upward, Collor made little effort to reach out to Congress or other key groups. He

¹ The period of this Estimate is the next year or so. (U)

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remained aloof from the midterm elections in late 1990, ignoring the opportunity to broaden his political support in Congress and key states—even refusing to endorse progovernment candidates [redacted]

Constitutional Constraints. Unlike President Menem in Argentina, Collor has had to operate in a political system that has stymied implementation of his reforms. He inherited a new Constitution written by a Congress intent on sharply reducing presidential powers. Laden with statist provisions and antiforeign and protectionist restrictions, it also favors state and local governments in the apportionment of national tax revenues and gives them the ability to borrow without central bank approval. The Constitution is unwieldy, ambiguous, and often requires implementing laws to become enforceable, but Congress thus far has blocked amendments Collor negotiated with party leaders and state governors. [redacted]

Crazy Quilt Party System. Brazil probably has the most fragmented and undisciplined political party system in Latin America. Few of the 20-odd parties have solid national organizations and most are state or regionally based and heavily susceptible to the directives and fortunes of governors and other political potentates. No party or formal coalition holds a majority in either house of Congress. Collor's party, the National Reconstruction Party, created in 1989 for his presidential candidacy, has fewer than 10 percent of the members. It has virtually no organization or representation at the state or municipal levels. [redacted]

Collor's New Political Approach

Collor reluctantly concluded last year that he had no choice but to seek consensus with Congress, key governors, and other influential interests:

- The more accommodating and consultative political approaches he has pursued this year have enhanced his political maneuverability and support.
- The appointment of Marcilio Moreira as economy minister in May 1991, and of other competent and respected Cabinet members since then, has improved his government's standing at home and abroad.

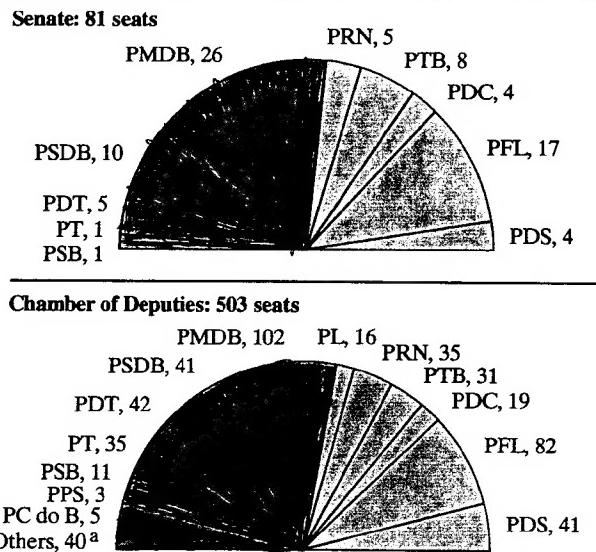
Figure 2
**Makeup of Brazilian Congress
as of May 1992**

PDS	Democratic Social Party
PFL	Liberal Front Party
PDC	Christian Democratic Party
PTB	Brazilian Labor Party
PRN	National Reconstruction Party
PL	Liberal Party
PMDB	Brazilian Democratic Movement Party
PSDB	Brazilian Social Democratic Party
PDT	Democratic Workers' Party
PT	Workers Party
PSB	Brazilian Socialist Party
PPS	Popular Socialist Party
PC do B	Communist Party of Brazil

Listed roughly from left to right on the political spectrum, although ideological orientation is not a strong influence for most Brazilian parties.

^a These seats are distributed among six parties.

- [] Pro-Collar
- [] Anti-Collar
- [] Various affiliations



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- By allying with the second-largest party and several other smaller ones, Collor regained some initiative and can now count on about 40 percent of the vote in Congress.
- His courtship of key governors has strengthened his political flanks in major states

Outlook for Passage of the Economic Reform Program

On balance, we believe the odds are somewhat better than even that Collor will gain congressional approval for most of the key elements of his fiscal reform and constitutional amendment packages this year.

But Collor will have to pressure, negotiate, and wheedle for the additional support he needs to win passage of his constitutional and economic reform legislation.

Success would tend to improve business confidence, lower inflation and interest rates, and reduce high domestic debt service costs, particularly during 1993. [b](1) [b](3)
Potentially the most important provision—a new financial transactions tax—would generate up to \$10 billion in revenues next year, equal to 2.5 percent of GDP. With other revenue-raising measures likely to be passed, the fiscal reform could reduce the budget deficit by nearly 6 percentage points. But to get these key measures passed, Collor will probably have to significantly compromise other legislative objectives.

Several important bills are scheduled to be voted on in June, providing early tests of Collor's congressional support.

Relations With Commercial Banks

An agreement in principle with Brazil's Bank Advisory Committee on reducing commercial debt and debt service payments is likely by late summer. Finalization of the accord with about 500 creditors probably will not occur until early next year, however. The agreement could reduce \$40 billion in medium- and long-term debt by \$3.5 billion and cut 1992-93 interest payments by \$500 million. Because Brazil has been paying only 30 percent of the interest due, however, payments to bankers would actually rise. Consequently, the chief benefit of normalized financial relations is likely to be greater confidence in the Collor government's economic management and a return of flight capital.

Progress has been made in curtailing the constitutional rights of states to borrow without central bank approval, but they will retain sufficient autonomy to undermine Brasilia's monetary policies. Constitutional provisions that earmark fixed percentages of national taxes for state and municipal governments are unlikely to be rescinded. Moreover, the federal government's inability to force states to invest productively instead of maintaining large bureaucracies will continue to be a drag on the economy

The government has had considerable success in privatizing state enterprises, and we expect further progress over the next year or so. It should be able to auction off most of the 28 firms scheduled to be sold by the end of next year. Their disposal would trim the federal payroll by more than 80,000 employees. Hundreds of state-owned companies remain, however.

Investment is likely to increase moderately. Lower interest rates, diminished impediments to business operations, a somewhat lighter tax burden, brighter prospects for exports, and fewer uncertainties about economic policy would help promote private-sector

investment. Foreign firms would be encouraged by better protection for intellectual property rights and could play a somewhat larger role in bidding for parastatal firms

A declining number of layoffs, a recent rise in industrial production, and higher growth in the major industrialized countries that are the leading importers of Brazilian goods suggest that modest growth is likely during the second half of this year. Nonetheless, the continuation of fiscal and monetary austerity and political uncertainties will keep growth at 1 to 2 percent during the period of this Estimate. In addition, we expect the monthly inflation rate to remain in the low double digits

What if the Legislative Program Fails To Pass?

We believe there is a 40- to 45-percent chance that Congress will not approve the most critical portions of Collor's fiscal reform and constitutional package this year, thus derailing his stabilization program. Although the government would apply stopgap fiscal measures, these would do little to reduce the budget deficit. Confidence in the President and his program would plummet, triggering capital flight and spurring inflation. Compromise between the President and Congress would be highly unlikely. The likely departure of Economy Minister Moreira would probably be seen by markets as a harbinger of new wage and price freezes.

The economy would plunge again into negative growth, though probably not as deep as in 1990. Monetary policy would be tightened to attempt to keep the lid on inflation, and a new round of layoffs would raise the jobless rate above already high levels. Prospects for new investments would evaporate.

There would be important international implications as well. Any chance for compliance with IMF fiscal targets would be dashed. In addition, the likely loss of reserves and failure to abide by the IMF program probably would hold up the completion of a debt accord with commercial banks, further depressing confidence.

Civil-Military Relations

[Redacted]
In recent months, however, simmering dissatisfaction in the three services over the erosion of military salaries has resulted in public complaints, open pressure on the President and Congress, and even minor rallies by military dependents. [Redacted]

In response, the administration moved quickly in April to obtain congressional passage of an 80-percent military pay raise and is likely to narrow the sharp disparities between pay levels for military personnel and those of legislative and judicial branch functionaries. We believe that the high command will periodically pressure the government to raise salaries as long as inflation remains high, and additional isolated acts of indiscipline are possible [Redacted]

Finally, there is great uncertainty over what the military's future mission should be. Many officers are concerned that military prestige will further erode and that key decisions concerning force structures and missions will be made by civilian leaders, without military input. We believe Collor and the Congress will proceed carefully on issues of institutional concern to the armed forces [Redacted]

Political Implications. Collor would be politically impotent, the current moderate optimism about the administration's management of the economy would evaporate, and respected officials would depart.

Collor would have only scant prospects for restoring the credibility of his government and would be likely to veer from crisis to crisis through the remainder of his term, which ends in January 1995. [Redacted]

Criticism of the government would intensify almost in direct proportion to rising monthly inflation; strike activity and scattered labor violence probably would spread. Protests and food riots would probably occur in some cities, and crime would soar. But we believe

the military would intervene only in the event of widespread instability in one or more major cities and if elites openly called for the military to act. [Redacted]

The Intelligence Community is divided over the likely outcome of the April 1993 plebiscite in which Brazilians will choose between presidential and parliamentary forms of government.² The main parties and prospective 1994 presidential candidates have not yet signaled their intentions, and we doubt that many have yet focused on the importance of the choice. Collor, who expressed support for a parliamentary system when he believed he stood a good chance of being elected Prime Minister, is now undecided. [Redacted]

Some agencies believe that Collor's congressional defeat would not translate into a vote in favor of parliamentarism.³ They believe the electorate will be influenced by a much broader range of factors than Collor's perceived failures; these include the population's hesitancy to abandon a familiar system and the likely impact of prospective presidential candidates who would favor the present system. Other agencies believe the deterioration that would follow a congressional defeat would increase the likelihood of approval of a parliamentary system to about 60 percent.⁴ They believe that support among politicians is already surprisingly high and that parliamentarism would be popular as a mechanism to marginalize Collor. [Redacted]

Relations With the United States

Collor believes that his administration has made considerable headway in improving Brazil's image on a variety of fronts, bringing it back from the acute disrepute of the waning days of his predecessor's term. He is convinced that he has met the bulk of Washington's concerns on issues that were nettlesome at the outset of his term. He also evidently is sanguine that

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the summit in Rio will be widely viewed as a success and that it will give him additional clout with his Congress. [redacted]

A proposed law protecting Intellectual Property Rights—long sought by the United States—has attracted opposition from nationalists, the pharmaceutical industry, and the Catholic Church. But we believe it is likely to be approved later this month.

In conversations with US officials during the summit, Collor and his representatives will offer up a catalogue of constructive actions taken by his government in areas such as nuclear safeguards, strategic trade controls, moves toward adherence to Missile Technology Control Regime guidelines, regional CBW bans, trade liberalization, cooperation with the United States on GATT, and, in general, constructive stances in line with those of the United States in international forums. [redacted]

The Brazilians are also likely to cite numerous bilateral initiatives they have taken during the same period. While Collor remains concerned about US trade policies that he believes put Brazil at a disadvantage, a top priority will be to seek US understanding of the reasons for Brazil's noncompliance with IMF targets. [redacted]

Collor was one of the first Latin American leaders to support the Enterprise for the Americas Initiative and, with Menem of Argentina, accelerated formation of the MERCOSUR regional common market. Brazilian cooperation with the United States on counter-narcotics issues is likely to continue expanding gradually, but, because of budgetary and other constraints, Collor has not assigned it a high priority. [redacted]

Collor is not expecting to have in-depth discussions with President Bush on unresolved bilateral issues during the summit. However, he and his aides believe their efforts to satisfy the concerns of the United States and other developed countries have not been reciprocated. While Collor may not yet be inclined to react forcefully to this perceived inadequate response, he might smart from further admonitions that Brasilia needs to do more, especially if such a message were conveyed during the summit. [redacted]

Brazilian Policy on Key Regional Issues

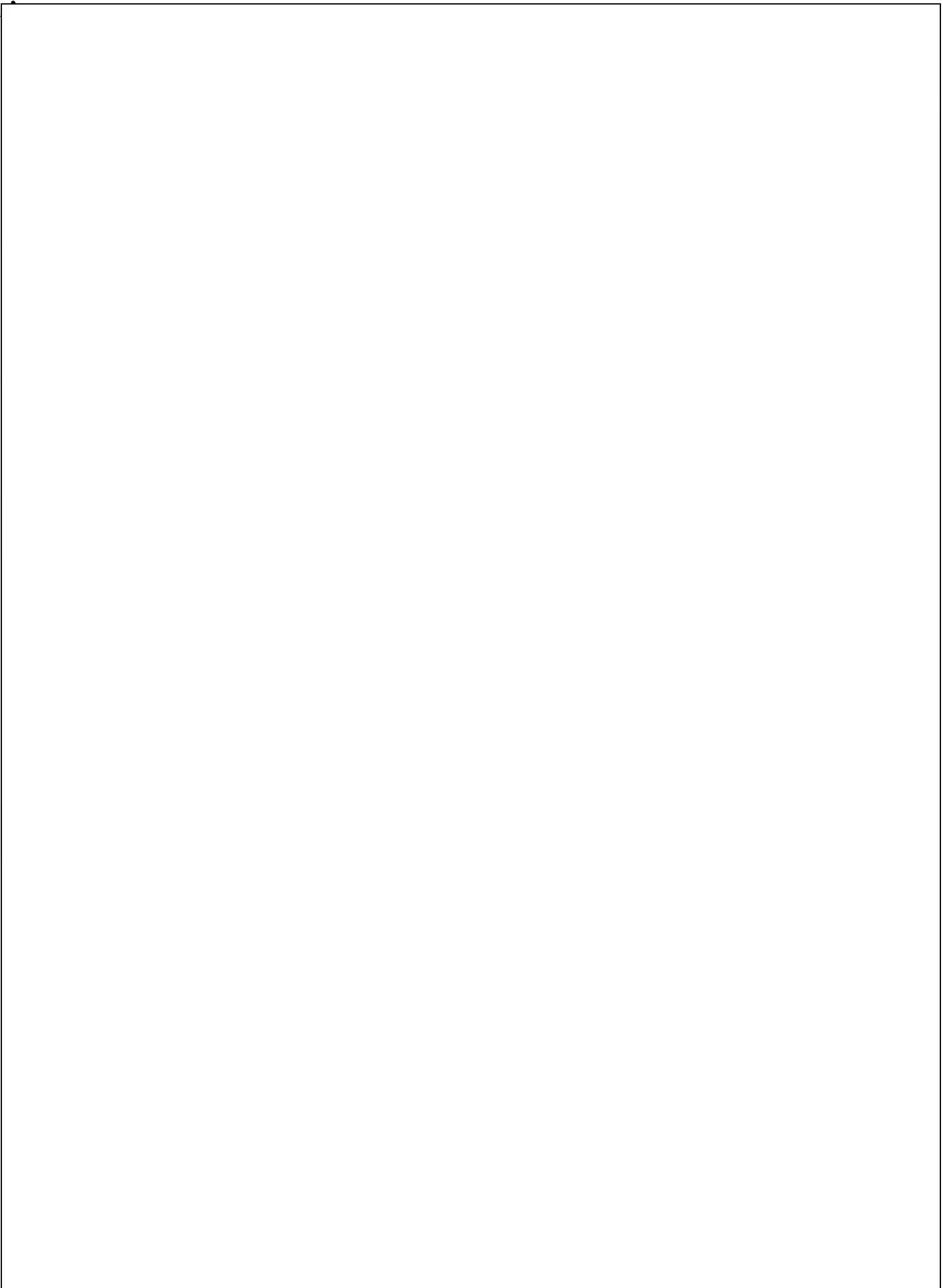
Cuba. Brasilia has long favored dialogue with Havana as a way to promote change in Cuba and to facilitate its reintegration into the Latin American community. Since Brazil and Cuba restored relations in 1986, trade relations have expanded moderately. In early May, Brazil's Mines and Energy Minister confirmed to the US Ambassador that the state-owned petroleum company had just signed a four-year \$52 million exploration contract with Havana, which includes drilling three oil wells in Cuba's coastal waters. In response to the Ambassador's call for canceling the contract, the Minister claimed that the company would "do the minimum" under the agreement. The Ambassador subsequently demarched the Brazilian Foreign Minister, who promised to look into the matter, but evidently has not yet provided any further response. [redacted]

Haiti. Shortly after the Haitian coup, Brasilia promised to enforce the Organization of American States (OAS) embargo, but failure to enact its own sanctions has allowed some Brazilian exporters to continue shipping goods to Haiti. Brazil has not advocated the use of force to restore President Aristide, but it might participate in a multilateral peacekeeping mission if approved by the UN Security Council. [redacted]

Peru. Brazilian diplomats have expressed profound concern about the possible repercussions throughout Latin America of the attempted coup in Venezuela last February and Peruvian President Fujimori's antidemocratic actions since April. Brasilia is maintaining diplomatic relations with Lima but has suspended the few cooperation projects between the two countries. Collor supports efforts in the OAS and the Rio Group to insist that Fujimori keep his promises to restore democracy. [redacted]

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